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Lucia A Keegan 11/28/2006 09:57:12 AM From DB/Inbox: Lucia A Keegan

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TAGS: ENRG EPET EIND EINV ELAB PREL PGOV FR
SUBJECT: FRENCH ENERGY BILL PRIVATIZES GDF, FREEZES ELECTRICITY AND GAS PRICES, AND TAMES INDEPENDENT REGULATOR

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Summary

¶1. (SBU) On November 14, the European Commission announced that the French energy conglomerate Suez and the 70 percent GOF-owned Gaz de France (GDF) had satisfied concerns about the proposed merger's impact on competition after the two firms promised to sell off some prime assets in Belgium. GDF will sell its 25.5 percent stake in the Belgian electricity company SPE, the main competitor of Suez subsidiary Electrabel. The Commission's decision paves the way for the expected 70.8 billion-euro merger. The EU decision follows the French Senate's November 9 final approval of the GOF energy bill, which further privatized the national gas utility, GDF. The French Senate also approved the opening of French gas and electricity markets to full competition by the EU deadline of July 1, 2007, but also included provisions for maintaining government-regulated tariffs during a transition period beyond 2007. The composition and role of France's independent energy regulator CRE have also been revamped, in part by adding more parliamentarians. This could compromise CRE's independence. End Summary.

Privatization of GDF

¶2. (U) The GOF Energy bill approved by the Senate on November 9

calls for the GOF to lower its equity stake in GDF below 70 percent. (GDF's partial privatization in 2005 was accompanied by a government commitment, stipulated by law, not to cut the state's share below 70 percent.) The French state currently owns 80.2 percent of GDF, and would see its stake in the merged entity fall to a third. The European Commission has allowed the French Government to retain a "golden share" in the merged entity, protecting GDF's gas distribution network, liquefied natural gas terminals and storage depots from takeovers. The golden share would provide the GOF with veto powers, for a restricted period, to ensure that private owners do not take decisions counter to national strategic interests.

GDF-Suez Merger

¶3. (U) While Parliament reviewed the energy bill, the heads of both companies agreed on how to divvy up management responsibilities of their combined group. Suez Chief Executive Gerard Mestrallet will become Chairman and Chief Executive of the new entity, while GDF CEO Jean-Francois Cirelli will become Vice-Chairman and President. The merged group is expected to become operational from January 2007. According to the presentation document on the Suez website, the merged group will have six separate businesses. In terms of its gas operations, GDF-Suez will be the number one buyer and supplier of gas in Europe and manage the largest gas transportation and distribution network in Europe. The new group also expects to be the fifth largest producer and supplier of electricity in Europe and a "world leader" in liquefied natural gas (LNG).

European Commission approves merger following concessions

¶4. (SBU) The European Commission lifted a key obstacle to the tie-up by giving its green light to the proposed plan on November 14, which should ensure the new group is operational as of 2007. To obtain EU approval, the two groups made a number of proposals focused on Belgium, where the companies would have had considerable market power as a merged entity. Under the proposals, GDF will sell its 25.5 percent stake in the Belgian electricity company SPE, which is the main competitor of Electrabel, the Suez subsidiary. Electrabel accounts for 90 percent of Belgium's electricity production and operates the seven nuclear reactors producing electricity in the country. Suez, for its part, will sell its stake in another Belgian subsidiary Distrigaz. However, the new group will retain 70 terawatts/per hour supplied under long-term contracts held by Distrigaz. The new group will also have a presence in Germany, Italy, Eastern Europe, Spain, Portugal, and, outside Europe, Brazil, the United States, the Middle East and Thailand.

Additional steps for GDF-Suez merger

¶5. (SBU) There are a few more hurdles to clear before the firms can complete their merger. The Constitutional Court will review the merger at the request of the Socialist and Communist Parties by the end of November. Following a green light from the companies' respective employee representatives, the firms will submit the merger agreement to the Suez and GDF boards. They will also call for shareholders meetings on November 22, and announce the terms and conditions of the merger to be submitted to approval vote at two extraordinary general meetings, to be scheduled on November 29.

A limited electricity and gas market opening

¶6. (SBU) The Senate confirmed National Assembly amendments to the GOF bill that stray from EU energy directives designed to open up gas and electricity markets to full competition by July 1, 2007. The new provisions institute a "transitory market adjustment regulated tariff" for two years beyond the July 1, 2007 EU deadline for full energy market opening. This new tariff will be established by government order from the Junior Industry Minister, who is in charge of energy. Energy suppliers using this new tariff will receive compensation from the government. The compensation will be proportional to the volume of nuclear or hydro-based production the preceding year. Ministry of Economy, Finance and Industry Director General Dominique Maillard (Under Secretary equivalent) said the tariff would be in place for only two years and was necessary to

sell the bill politically. If the GOF asserted that the purpose of deregulation was to increase competition and thus lower fares, "the population would object" if prices contrarily rose, he said.

¶7. (SBU) Furthermore, the Senate approved the National Assembly's transformation of the role and make-up of the CRE ("Commission de Regulation de l'Energie"), which the legislature viewed as too independent and market-oriented. Parliamentarians and one consumer representative will now sit on the board of the CRE, which currently includes only senior civil servants. A new four-member committee within the CRE will be responsible for settling disputes and applying sanctions. It is not yet clear how these members will be nominated. However, the Chairman of this new committee will become the National Mediator for Energy, a new position that the bill has not defined clearly.

¶8. (SBU) In an electoral year, these moves have a clear political content, according to Cambridge Energy Research Associates (CERA) Electricity and Gas Director Jean-Marie Chevalier. The price freeze introduced by Parliamentarians is designed to raise an imaginary wall of protection against higher gas prices. In an attempt to ensure that this wall would remain in place, Parliamentarians had limited the CRE's independence in overseeing the French gas and electricity markets, Chevalier told us on November 13. The new regulated tariffs are bound to raise a few eyebrows within the European Commission. Maillard told us that the GOF will address the Commission's questions matter-of-factly and was confident the Commission would be satisfied.

Comment

¶9. (SBU) Parliamentary approval of the French energy bill and the European Commission's endorsement of the Suez-GDF merger are major victories for the French Government and Economy and Finance Minister Thierry Breton. Despite opposition from unions and a threatened, unprecedented filibuster by Social Party (PS) and Communist Party (PC) opposition lawmakers, the GOF succeeded in maintaining its original early 2007 timetable for both the Suez-GDF merger and implementation of the 2003 EU gas and electricity directives. The bill's provisions that could ultimately compromise the market regulator's independence, and that continue the GOF's role setting energy tariffs, are causes of concern among supporters of further liberalization of the gas and electricity markets in France.

Stapleton